

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE KOU-KAMMA MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Kou-Kamma Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Revenue

6. The municipality did not charge all service debtors for water usage every month during the financial year ended 30 June 2014. Due to the lack of adequate systems in place, it was impracticable for me to determine the full extent of the understatement of the service charge revenue. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary relating to the service charge revenue disclosed at R 22,0 million (2013: R 17,7 million) in note 19 to the financial statements.

Qualified opinion

7. In my opinion, except for the possible effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Kou-Kamma Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Impairments

9. As disclosed in note 3 to the financial statements an amount of R 26,9 million (2013: R 19,6 million) in respect of receivables from exchange transactions has been impaired as a result of non payment of consumer debtor accounts.
10. As disclosed in note 4 to the financial statements an amount of R 8,2 million (2013: R 8,1 million) in respect of receivables from non-exchange transactions has been impaired as a result of non payment of consumer debtor accounts.

Material Losses

11. As disclosed in note 33 to the financial statements the municipality incurred material losses relating to electricity totalling R2,3 million during the year as a result of incomplete records and insufficient infrastructure to provide the necessary information in this regard.

Unauthorised expenditure

12. As disclosed in note 32 to the financial statements the municipality incurred unauthorised expenditure totalling R16, 2 million during the year mainly due to non - cash items.

Irregular expenditure

13. As disclosed in note 32 to the financial statements the municipality incurred irregular expenditure totalling R 29,8 million (2013: R 20,0 million) as a result of not adhering to supply change management (SCM) regulations.

Financial sustainability

14. The municipality's current liabilities exceeded its current assets. This situation, along with other matters as disclosed in note 42, indicates that the municipality may encounter difficulty realising its assets and discharging its liabilities during the normal course of business.

Additional matter

15. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

16. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, non-compliance with legislation as well as internal control. I performed tests to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2014:

KPA 2 – Basic Service Delivery and Infrastructure Investment (Technical and Community Services).

18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected development priority is as follows:

KPA 2 – Basic Service Delivery and Infrastructure Investment (Technical and Community Services)

Usefulness of reported performance information

Measures taken to improve performance not disclosed

22. Section 46 of the Municipal Systems Act (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 46% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of review of the presentation of the annual performance report by management.

Reported Indicators and targets not consistent with planned indicators and targets

23. Section 41(c) of the MSA requires the annual performance plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 93% of the reported indicators and targets were not consistent with those in the approved annual performance plan. This was due to a lack of review of the annual performance report by management.

Changes to indicators and targets not approved

24. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustment budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to a lack of controls in place and lack of review by management to ensure consistency.

Performance targets not specific and measurable and indicators not well defined and verifiable

25. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 40% of the targets were not specific.
- Performance targets must be measurable. I could not measure the required performance for 44% of the targets.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 58% of the indicators were not well defined.
- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 56% of the indicators were not verifiable. This was due to management not adhering to the requirements of the FMPPI due to a lack of technical indicator descriptions.

Reliability of reported performance information

26. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matter

27. I draw attention to the following matter.

Achievement of planned targets

28. Refer to the annual performance report on pages... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings expressed on reliability and usefulness and reliability of the reported performance information as reported above.

Compliance with legislation

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows.

Strategic planning and performance management

30. Measurable performance targets for the financial year with regard to each of the objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
31. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
32. The annual performance report for the year under review did not include:
- a comparison of the performance with the previous financial year and
 - measures taken to improve performance,
- as required by section 46 (1)(b) and (c) of the MSA.
33. The performance management system and its related controls were inadequate as it did not describe and represent the processes of performance (planning, monitoring, measurement, review, reporting and improvement) and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Budgets

34. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements and annual report

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Audit committee

36. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i), as these were not provided to them timeously.

Procurement and contract management

37. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
38. Contracts were extended/ modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
39. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

Expenditure management

40. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants and transfers

41. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant allocation, Municipal Systems Improvement Grant allocation, and Local Government Financial Management Grant allocation, as required by section 12(5) of the DoRA.

Revenue management

42. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.
43. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

44. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

Consequences management

45. Unauthorised, irregular expenditure and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA, as R15 million of the unauthorised expenditure related to non-cash items, and R28 million of the irregular expenditure related to current year expenditure on a housing tender entered into in the prior year.
46. Council certified unauthorised, irregular expenditure and fruitless and wasteful expenditure as irrecoverable without having conducted an investigation to determine the recoverability of the expenditure, in contravention of section 32(2)(a)(ii) of the MFMA.

Internal control

47. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

48. Leadership have not instituted all the disciplines necessary to enable effective oversight that promotes efficiency and effectiveness in financial management, service delivery reporting and compliance with laws and regulations, thus not setting the correct tone for the credibility of all reports generated by the administration. Consequently repeat audit findings occurred during the year under review.
49. Leadership have not implemented an effective performance management system that enables the leadership to monitor, oversee and hold all personnel accountable for the work that they perform through proper consequence management.
50. Leadership has not sufficiently exercised their oversight responsibility over performance information. This is as a result of inadequate reviews of documents pertaining to the performance information section.

Financial and performance management

51. The municipality did not fully implement and monitor controls over record management to ensure the maintenance of information that supports the reported performance. The lack of record management resulted in financial and performance reports not being accurate and complete. If not appropriately addressed by the municipality, this can impact the sustainability of the reported opinion. It is however noted that the financial statements were prepared internally in an effort to reduce the municipality's reliance on consultants.

52. There is a lack of processes in place to ensure compliance with laws and regulations. As a result management did not effectively monitor and address areas of non-compliance.

Governance

53. A risk register has been put in place and an internal audit unit has been appointed. However, the risk assessment which took place during the year was inadequate and risks identified in this assessment were not appropriately addressed within the control environment. The internal audit unit did not conduct all required audits per the internal audit plan. The audit committee was also not provided with required information in a timely manner to allow them to adequately report on this information. Due to these limitations the municipality could not be sufficiently guided regarding internal controls, financial, performance and risk management.

Auditor-General

East London

30 November 2014



**AUDITOR-GENERAL
SOUTH AFRICA**

Auditing to build public confidence